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POLICY REVIEW: TOWARDS REVITALIZATION OF THE GSP

Policy options and proposals for the revitalization of the generalized system of preferences*

Report by the UNCTAD secretariat

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INTRODUCTION

1. The generalized system of preferences (GSP) began to be implemented in 1971 and became fully operational in 1976. There are now 14 GSP schemes in operation offered by 29 preference-giving countries, including the 15 member countries of the European Union. GSP imports into OECD preference-giving countries amounted to US$ 79 billion in 1993, a more than sevenfold increase over the 1976 level. Today the GSP is still regarded as an effective trade policy instrument in favour of developing countries through the stimulus it provides to the expansion and diversification of their exports.

2. There have been two major reviews of the GSP, in 1979 and in 1990. As the Uruguay Round negotiations were a priority consideration for most preference-giving countries in the early 1990s, no major revisions were made to GSP schemes until the Round was concluded. The new situation brought about by the successful conclusion of the Round, however, gave rise to a pressing need for a policy review of the GSP.

3. At its twentieth session, in 1993, the Special Committee on Preferences agreed to undertake such a policy review at its twenty-second session in 1995. The Committee called for the convening of ad hoc expert group meetings by the Secretary-General of UNCTAD.[1] Two meetings of the Ad Hoc Expert Group took place in February 1994 and May 1995.[2] Senior experts discussed key elements of the GSP system and adopted a number of conclusions and recommendations for its revitalization. At its twenty-first session, in 1994, the Special Committee on Preferences recommended to the Trade Development Board that, as part of the preparations for the 1995 policy review, an Intergovernmental Group of Experts on Rules of Origin be established in order to make proposals on the simplification, harmonization and improvement of the rules of origin. This Group met in July 1995 and made recommendations on the full harmonization of origin criteria among preference-giving countries.

4. This report draws on these various conclusions and recommendations. Chapter I examines the main characteristics of the GSP in retrospect as well as the implications of the Uruguay Round for the GSP, and considers various issues which pose a challenge to the GSP in the long-term. Recent developments regarding the implementation, maintenance, improvement and utilization of the GSP, rules of origin and technical cooperation are reviewed in the eighteenth general report (TD/B/SCP/12). Chapter II discusses the scope for extending the GSP, as a trade policy instrument, to new areas of economic activity. Chapter III puts forward some policy options designed to revitalize the GSP. The main elements of these proposals concern: the extension of product coverage; exoneration from tariffs; the adoption of criteria for country-product and country graduation compatible with the underlying objectives of the GSP; the strengthening of special treatment for the least developed countries, particularly in the areas of product coverage, rules of origin and technical cooperation; and the endorsement of the recommendations of the Intergovernmental Group of Experts on the harmonization of rules of origin. The tables referred to in this report are contained in a statistical annex (TD/B/SCP/13/Add.1).

Chapter I

THE GSP IN PERSPECTIVE

A. Objectives of the GSP

5. As stated in UNCTAD Conference resolution 21(II), "...the objectives of the generalized, non-reciprocal, non-discriminatory system of preferences in favour of the developing countries, including special measures in favour of the least advanced among the developing countries, should be: (a) to increase their export earnings; (b) to promote their industrialization; (c) to accelerate their rates of economic growth".

6. A subsequent step in recognizing the special status of the GSP was taken in GATT after the conclusion of the Tokyo Round when the "enabling clause" was agreed among the Contracting Parties. According to this clause, which recognized the value and existence of the GSP, developing countries were expected to take on more responsibility according to their degree of development under the GATT multilateral trading system.

7. The General Principles governing the Uruguay Round negotiations, contained in the Punta del Este Declaration, stipulated that "... (iv) ... the principle of differential and more favourable treatment embodied in Part IV and other relevant provisions of the General Agreement and in the decision of the Contracting Parties of 28 November 1979 on Differential and More Favourable Treatment, Reciprocity and Fuller Participation of Developing Countries applies to the negotiations". In general, the Uruguay Round Agreements, with some exceptions, provide for differential and more favourable treatment for developing countries. However, at the end of the Uruguay Round negotiations there was no specific provision which addressed directly the role of the GSP in international trade and more specifically the role for which the GSP was designed since its inception.[3]

8. If the GSP is to remain an effective trade policy instrument in the post-Uruguay Round era, the whole system has to be strengthened and restructured. A strengthening of the GSP is particularly necessary to respond to the needs of those beneficiary countries which are lagging behind in their participation in world trade and in their utilization of existing GSP schemes. As to restructuring, it is recalled that the GSP is the result of a consensus reached at a multilateral level, and its role in the new trading environment - which may include non-traditional areas, such as trade in services and investment - should be reaffirmed according to its original objectives and principles. This issue could be eventually considered in multilateral consultations within the Special Committee and at UNCTAD IX.

B. Principles of the GSP

9. The three basic principles enunciated in the Conference resolution referred to above have been reaffirmed on subsequent occasions in UNCTAD, and, most recently, by the Cartagena Commitment in 1992, which stated, *inter alia*:

> *"135. The Conference recommends that preference-giving countries comply with the multilaterally agreed principles of the GSP. Preference-giving countries should consider appropriate adjustment in country coverage. The Conference recognizes that a substantial expansion of product coverage to include hitherto excluded products of current and potential export interest to developing countries would constitute a major improvement in the effectiveness of the GSP and calls upon preference-giving countries to consider, if possible, comprehensive product coverage, especially in the context of the review of the schemes under way in many preference-giving countries. Limitations and restrictions on preferential imports, as well as withdrawals of preferential benefits, should be minimized, and the rules of origin should be simplified and harmonized, where possible, so as to impart stability, transparency and greater predictability to the schemes and to reduce their complexity".*

10. The three basic principles have not been fully observed from the outset and divergence from them has been growing over time. The first principle, i.e. generality, called for a common scheme to be applied by all preference-giving countries to all developing countries. In practice, there are wide differences among the various GSP schemes in product coverage, depth of tariff cuts, safeguards and rules of origin. While a certain degree of harmonization exists in the area of product coverage, some schemes do not cover the textiles and clothing sector entirely. In the case of rules of origin, two different sets exist.

11. The second principle, non-discrimination, implies that all developing countries should be covered and treated equally under the schemes. In this connection, a "positive" differentiation among beneficiaries allows for special measures for LDCs which are justified by their particular economic and development situation.

12. The third principle, non-reciprocity, means that beneficiaries are not called upon to make corresponding concessions in exchange for being granted GSP beneficiary status. However, certain preference-giving countries place conditions on eligibility and some have withdrawn preferences indirectly. This action implies a certain degree of reciprocity of concessions or conformity with a certain pattern of behaviour.

13. In the case of the United States, adequate and effective protection of intellectual property rights and internationally recognized workers' rights constitute conditions or eligibility criteria for designating developing countries as beneficiaries. The argument is that the GSP's objective of aiding economic development would not be adequately achieved without parallel development of adequate intellectual property rights and workers' rights.

14. The General Accounting Office's (GAO) report states that "the (United States GSP) programme became more reciprocal in nature."[4] The 1984 Act states that the GSP is intended to promote the economic development of beneficiaries, notes that trade, rather than aid, is a more effective way of achieving this goal, and points out that the amended GSP law is meant to integrate developing countries into the international trading system with its attendant responsibilities in a manner commensurate with their development. The report further states that GSP has an increased focus as a leveraging tool that can be used to encourage desired behaviours in beneficiaries in exchange for continued GSP benefits. However, developing countries have characterized these "conditionalities" as inappropriate when attached to what, in effect, is a trade assistance programme that traditionally required no reciprocal action by beneficiaries.[5]

15. The European Union, in its 1995 scheme, was planning to grant additional preferences to beneficiary countries which comply with certain prescribed, internationally-recognized environmental and social standards from 1997 onwards. These additional benefits are expected to improve the quality of development in beneficiary countries through the application of more advanced social and environmental policies and to compensate partly for the supplementary costs required to attain these policies. The European Union has, however, postponed the entry into force of these "additional incentives" until further consultations are held in international fora. Reservations have indeed been expressed in some quarters regarding the appropriateness of this new approach. The inclusion of broader development criteria, such as social and environmental concerns, may attach further conditionalities to an instrument which has been traditionally developed within the trade context, as well as create practical difficulties of implementation.

16. Similarly to the United States scheme, a new provision has been added to the GSP scheme of the European Union which may lead to withdrawal of a beneficiary country from its scheme if, *inter alia*, it manifests cases of unfair trading practices, including discrimination against the Community and failure to comply with obligations under the Uruguay Round to meet agreed market access objectives.

17. Overall, the principles of the GSP have often been interpreted so as to serve industrial interests, protective purposes or non-economic goals. However, the principles and objectives of the GSP should be read together as they both serve the developmental goals agreed multilaterally within UNCTAD.

C. Assessment of the GSP

18. The original objectives of the GSP - to accelerate economic growth, promote industrialization and to increase export earnings - were conceived as an interim goal on the way to a broader goal of promoting development and the integration of developing countries into the global economy. While the GSP has produced unmistakable benefits in terms of export growth in beneficiary countries, various restrictive measures have been subsequently introduced which affected its potential. Limited product coverage, insufficient tariff cuts, graduation measures and excessive stringency of rules of origin continue to hamper the GSP from becoming an effective tool for development.

19. Total imports of preference-giving countries from GSP beneficiary countries in 1993 amounted to US$ 438.6 billion, of which US$ 304.8 billion were dutiable (see annex, table 1).* However, only US$ 171.6 billion, or 56.3 per cent, of dutiable imports were covered by the various schemes and, of this, only US$ 82.2 billion or 47.9 per cent, were actually granted preferential treatment. In effect, therefore, only slightly more than one fourth of dutiable imports received GSP treatment. In 1993 the share of the three largest schemes, those of the European Union, Japan and the United States, accounted for more than four fifths of both GSP-covered and preferential imports from beneficiaries.

20. Between 1976 and 1993 the total value of preferential imports under the OECD schemes rose from US$ 10.4 billion to US$ 79 billion, at an average annual growth rate of 12.7 per cent. Although this growth rate falls to 8.4 per cent, when adjusted for inflation, it still represents a significant achievement. In this context it should be noted that, because of changes in the composition of developing countries' exports, the proportion of dutiable exports in total exports has risen significantly - from under 40 per cent in 1976 to over 70 per cent in 1993. However, this trend has not resulted in a comparable improvement in the coverage ratio for all OECD schemes which rose from 45.8 per cent in 1976 to 55.9 per cent in 1993. This finding suggests the continued existence of a mismatch between the export structure of GSP beneficiaries and the product coverage of the OECD schemes.

21. Another feature of the GSP which has become progressively more pronounced under the three major schemes, and thus for the GSP as a whole, is that a limited number of beneficiary countries account for the greater part of covered and preferential imports. In 1992 the twelve largest beneficiaries in the European Union scheme supplied 80 per cent of preferential imports; the seven largest in the Japanese scheme supplied 75 per cent of Japan's preferential imports; and the six largest beneficiaries in the United States scheme accounted for 71 per cent of that country's preferential imports, although these beneficiaries were affected by limitations in the form of quotas, tariff ceilings and maximum country amounts.[7]

22. Growth rates of preferential imports from the LDCs in the period 1976-1993 were on average lower than those for all beneficiaries taken together. They rose on average by 11.6 per cent annually for all OECD schemes, as opposed to 12.7 per cent for all beneficiary countries. Under the European Union scheme,[8] preferential imports from the LDCs grew at an average rate of 16.6 per cent as opposed to 14.3 per cent for all beneficiaries. The comparable figures for the Japanese scheme were 24.2 per cent and 12.8 per cent, respectively. However, under the United States scheme, preferential imports from the LDCs fell at an average rate of 0.6 per cent while those of all beneficiaries rose by 11.3 per cent.

23. The share of imports into OECD preference-giving countries from GSP beneficiaries fell from 20.2 per cent of their imports from all sources in 1976 to 17.1 per cent in 1993. This outcome has been interpreted by some as a setback for the GSP concept since preferential treatment did not contribute to an increase in exports from beneficiaries. However, this argument must be considered in the light of the fact that almost half of dutiable imports from

beneficiaries are not covered by GSP schemes and more than half of covered imports do not receive preferential treatment. Thus, the degree to which exporters in beneficiary countries were not able to make use of the GSP because of limited product coverage and *a priori* restrictions cannot be taken as a measure of the ability of the GSP to meet its goals of export promotion, industrialization and growth. This holds particularly true when one considers that in the areas where GSP was not subject to the above-mentioned restrictions, the annual growth rate of OECD preferential imports over the period 1976 to 1993 was 12.7 per cent.

24. A report by the UNCTAD secretariat in the late 1980s summarizes various studies on the economic effects of the GSP.[9] These studies suggest that the increase in the value of beneficiary trade attributable to the GSP, including both trade creation and diversion, might be within a range of 7 to 22 per cent of preferential exports. The studies also concluded that enhanced export earnings had permitted increased investment but that it was hardly possible to be more precise about the specific contribution of the GSP.

25. This analysis should be considered alongside the studies, sponsored by UNCTAD and ESCAP,[10] of the effects of product graduation in four countries in South East Asia (Singapore, Hong Kong, Republic of Korea and Taiwan, Province of China) and the effects of these graduations on neighbouring countries. The studies considered the experiences of the four countries which have been arguably the most constrained by quantitative restrictions, both tariff quotas and product graduation, in their access to the benefits of the European Union and United States schemes.

26. The studies found that product graduation (and tariff quotas and ceilings under the European Union scheme) led to a loss of market share. It did not, however, lead to higher exports by the less competitive beneficiaries; it was rather the advanced industrial countries or other major beneficiaries who gained. When country graduation excluded Singapore, Hong Kong, the Republic of Korea and Taiwan Province of China from the United States scheme, the shares of Indonesia, Malaysia and Thailand in both covered and preferential imports rose, and they rose faster than these countries' shares in total United States imports. Examination of individual products supports these conclusions from the overall statistics.

D. The implications of the new world trading system

27. The world trading order has changed radically with the Uruguay Round Agreements and the establishment of the World Trade Organisation (WTO). In addition, the formation of large regional groupings is accelerating. Some 118 countries participated in the Round of which a majority (97 countries or 83 per cent of the total) were developing countries. The Round dealt not only with traditional areas, such as trade in goods, but also new areas, such as trade in services and trade-related aspects of investment measures and intellectual property rights. The Round produced agreements on trade in the agricultural and textiles and clothing sectors which are major areas of export interest to developing countries. In addition to the MFN tariff reductions, the concept of "tariffication" has been introduced for agricultural products formerly subject to quantitative restrictions and other measures. The MFA regime, which takes the form of "quotas" applied under bilateral arrangements, will be integrated into the multilateral trading system over a 10-year period. These aspects of the Agreements have major implications for the potential expansion of product coverage of the GSP. The Uruguay Round also broke new ground in bringing non-preferential rules of origin into the framework of multilateral rules. This may have implications for the further improvement of rules of origin within the GSP.

28. The general strengthening of the international trading system and the establishment of the WTO have created a new global trading environment in which developing countries have actively participated. The commitments undertaken by developing countries in specific areas, such as TRIMS, TRIPS and services are expected to further attract foreign direct investment. But the new opportunities created by the Uruguay Round Agreements can be fully exploited by developing countries only if appropriate policies and measures are taken at both

the national and international levels to enable them to overcome the remaining economic and institutional obstacles which stand in the way of their adjusting to the new global trading environment.

29. In 1979, following the conclusion of the Tokyo Round, preference-giving countries agreed to a 10-year extension of the GSP and to the "enabling clause" which gave a legal basis to the GSP within the GATT context. While developing countries were free to choose which agreements they wished to accede to following the Tokyo Round, in the case of the Uruguay Round the situation is substantially different. Developing countries wishing to accede to the WTO must accept and implement in their national laws all agreements annexed to the Marrakesh Agreement establishing the World Trade Organization under the "single undertaking" requirement. It will be a considerable burden for developing countries, in particular the LDCs, to adjust to this newly established world trading system. While benefits will be acquired in the medium- and long-term, the special and differential provisions contained in many of these multilateral agreements are unlikely to compensate for all the adjustment and compliance costs of their WTO commitments." Moreover, there will be long lags in the liberalization of trade in some of the products of particular interest for developing countries. A strengthening of the GSP could certainly contribute to the restructuring and upgrading of developing countries' external trade. Moreover, an improved GSP would provide developing countries with an incentive to make the necessary reforms so that they can participate more actively in the international trading system.

30. A strengthened GSP would also help developing countries overcome another challenge arising from the Uruguay Round Agreements, the resulting erosion of GSP margins. Following the tariff reductions agreed during the Uruguay Round, average MFN tariffs in industrialized countries will decline by about 48 per cent on a trade weighted basis, some 40 per cent of imports will enter duty free (including those of the 11 sectors for which tariffs were eliminated in the Round),[12] and the proportion of tariffs which are bound will rise from 78 per cent to 97 per cent. For agricultural products, all non-tariff measures are converted to customs duties ("tariffication"), the resultant tariffs and all other agricultural tariffs will be gradually reduced on a simple average basis by 36 per cent (with a minimum reduction of 15 per cent per tariff line) and bound (i.e. 100 per cent binding). In the textiles and clothing sector, the average tariff level, which had always been considerably higher than for all industrial products in the developed countries, will be gradually reduced by 22 per cent compared to 48 per cent for all industrial products."

31. To illustrate the extent, and the trade implications, of the reduction of MFN rates and its impact on GSP preferential margins, the following analysis focuses on the three largest markets of preference-giving countries (i.e. European Union, Japan and United States) which account for about 83 per cent of preferential imports. The analysis is confined to the implications for GSP and does not cover other preferential schemes operated by these preference-giving countries (such as the Lomé Convention or CBI).

32. A summary picture of estimates of the average loss in preferential margins implied by the MFN tariff reductions of the three major donor countries is shown in table 2 of the annex. The analysis takes into account, on a tariff line basis, the preferential margin available pre- and post-Uruguay Round and the margin loss due to the MFN tariff reduction. The analysis was carried out on a trade-weighted basis using imports from effective beneficiaries which received GSP treatment. The tariff margins take no account of *a priori* restrictions on access to preferential treatment and exclude largely tariffied agricultural products." According to these estimates, there is an average loss in preferential margins for all GSP-receiving imports from non-LDC beneficiaries of about 2.9 percentage points (1.4 for LDCs) in the European Union, 2.6 percentage points (4.1 for LDCs) in Japan and 2.8 percentage points (2.7 for LDCs) in the United States. For the three schemes together, the average loss amounts to 2.8 percentage points (2.1 for LDCs), which represents a substantial erosion of the margin of preference. On a sectoral basis the highest loss of preferential margins for both non-LDC and LDC beneficiaries in the European Union occurs for tropical agricultural products and natural resource based products, a loss of more than 4 and 6.3 percentage points, respectively. In the United States the highest loss was recorded in tropical industrial products for

LDCs and in agricultural non-tropical products for non-LDC beneficiaries (a loss of 3.8 and 3.2 percentage points, respectively). In Japan the highest loss occurred in leather and footwear products for LDC beneficiaries and in tropical agricultural products for non-LDCs (a loss of 23.3 and 10.8 percentage points, respectively).

33. Another source of erosion of the benefits that accrue from the GSP is the continuing trend towards regionalism. The enlargement of the North American Free Trade Area could result in a potential reduction of GSP trade as trade diversion takes place from preference-receiving countries to new NAFTA members. In particular, the export structure of Mexico is similar to that of other Latin American and South-East Asian preference-receiving countries. Trade diversion will also occur if preference-giving countries select particular groups of developing countries for special preferences. For example, under the Andean Trade Preference Act (ATPA), Andean countries are granted a special programme of tariff preferences by the United States to help them in their fight against drug trafficking. The European Union gave similar special treatment in 1990 to Andean and Central American countries, but within the GSP scheme.

E. Agricultural and textile product liberalization in the Uruguay Round

34. The market access results of the Uruguay Round Agreement on Agriculture have opened new possibilities for GSP. First, all former non-tariff measures affecting certain sectors of agricultural trade in preference-giving countries have been converted into tariffs equivalent to either specific or ad valorem duties. Secondly, all agricultural tariffs are to be reduced by 36 per cent with a minimum reduction of 15 per cent for each tariff item over a period of 6 years. Finally, all agricultural tariff rates of all countries are bound.

35. The tariffication process has resulted in very high, frequently prohibitive tariffs which, although reduced over the scheduled six year period, will remain at a level which provides ample scope for GSP treatment. In order to maintain the established pattern of trade and to further liberalize trade in agriculture, therefore, the main preference-giving countries participating in the negotiations agreed to open tariff quotas on selected agricultural items. These quotas are sub-divided into two main categories: current access quotas, which primarily aim at maintaining the previous flow of trade, and "minimum access opportunities" quotas where previously there were no imports, or in addition to the "current market opportunities". An UNCTAD secretariat report" indicates that the import value of tariffied agricultural products for the European Union, Japan and the United States in 1992 amounted to US$ 14.4 billion, US$ 2.5 billion and US$ 2.8 billion, respectively. The share of developing countries in these imports was 56.8 per cent, 13.5 per cent and 12.6 per cent, respectively. Based on secretariat calculations (see annex, table 4), combined imports in 1992 from effective non-LDC beneficiaries of the GSP schemes of Japan, the United States and the European Union amounted to US$ 8.1 billion, of which US$ 1.1 million was GSP-covered and only US$ 625 million received GSP treatment. The bulk of the imports from beneficiaries, according to these estimates, is made by the European Union (US$ 7 billion). Thus, there is scope for expanding GSP treatment to these tariffied agricultural products where the proportion of GSP-covered imports in total imports for all three schemes is as low as 13.6 per cent. As mentioned above, it is likely that the immediate market access opportunities provided by the Agreement are in many cases limited to the opening of current access quotas. Besides, within these quotas, it remains to be ascertained to what extent individual preference-receiving countries will be entitled, or be in a position, to benefit. An expansion of GSP product coverage and substantial tariff cuts granted to these products would help developing countries to face the transitional cost of adjusting to the newly established multilateral disciplines and, as the case may be, to higher food prices.

36. The Uruguay Round Agreement on Textiles and Clothing provides for the progressive abolition of the Multi-Fibre Arrangement which has for years regulated trade. Moreover, this Agreement brings textile products within WTO disciplines for all Contracting Parties. Market access opportunities under this Agreement take place over an agreed period of 10 years in two respective areas: the first being the gradual elimination of quotas and the bilateral agreements; and the second the gradual increase of the remaining quotas.

37. However, according to a secretariat study" there are various features of this liberalization programme which indicate that the progressive removal of quotas is unlikely to have significant immediate effects on developing country trade. In fact, according to a provision of the Agreement, members have the opportunity to choose selectively which items to liberalize first and which may be postponed until the final stage. An examination of the first phase of the implementation of the Agreement on Textiles and Clothing reveals that few of the items constrained by MFA quotas have been liberalized, and there are strong indications that developed countries will liberalize only at a later stage products constrained by MFA restrictions.

38. A number of preliminary findings indicate that some small suppliers, whether or not subject to MFA quotas, may face transitional difficulties in adapting to the new market conditions. Over the more than 20 years of operation of MFA, such small suppliers and producers have established traditional flows of trade which risk encountering difficulties in view of the expected strong competition from major suppliers stemming from the liberalization process.

39. In parallel to the MFA liberalization programme, there have been tariff reductions concerning textile products. In this sector, the traditionally high tariffs applied by developed countries are expected to be reduced to an average level for GSP effective beneficiaries of 9.9 per cent for the European Union, 8.1 per cent for Japan and 15 per cent for the United States. Thus, the post-Uruguay Round average rate for textile products still provides scope for GSP benefits. These findings hold especially true when GSP data are examined. Of the three major schemes, imports which received GSP treatment in 1992 amounted to roughly US$ 6 billion out of US$ 24 billion of total textile imports from beneficiaries. In the case of Japan, out of US$ 9.9 billion GSP covered imports only US$ 846 million actually received GSP treatment. In this latter case, the utilization rate was as low as 8.5 per cent. In the case of the United States, out of US$ 9 billion imports from beneficiaries, for the few products covered by the scheme the amount of trade was equal to US$ 155 million, of which US$ 125 million actually received GSP treatment. The bulk of preferential imports of textile products from beneficiary countries was made in 1992 by the European Union, which accounted for slightly over US$ 5 billion of preferential imports out of US$ 14 billion of covered imports. These data show the structural differences which were embodied in these GSP schemes. In short, the European Union under its old scheme had the widest coverage of textile items, but the volume of trade which actually received GSP treatment only amounted to roughly one-third of that of GSP covered products. This was due to *a priori* quantitative limitations and strict rules of origin. The same findings apply to the Japanese scheme, but to an even greater extent since the ratio between the amount of trade covered and that which actually received GSP treatment was 10 to 1. The case of the United States is substantially different since the main shortcoming is the virtual exclusion of textile products from its GSP scheme.

40. Under the new GSP scheme of the European Union, the previous *a priori* limitations have been eliminated through the introduction of "tariff modulation". In the textile sector, this process has been translated into a preferential margin of 15 per cent of the MFN rate. Given that the post-Uruguay Round MFN average tariff on textile products is 9.9 per cent, the average preferential margin is 1.5 percentage points. It should be noted that LDCs continue to enjoy duty-free treatment on textile products and the previous distinction between MFA and non-MFA signatories has been eliminated.

F. Product coverage

41. From the outset of the GSP the product coverage has varied from one scheme to another owing mainly to differing national interests in preference-giving countries. In general, the industrial sector, falling within HS chapters 25 to 97, is covered to a larger extent than the agricultural sector. Coverage of this latter sector, falling within HS chapters 1 to 24, is very limited. As a result, only about 50 per cent of all dutiable exports from beneficiary countries are covered by GSP schemes, of which roughly half are accorded GSP treatment. This means that only a quarter of all dutiable exports enjoy GSP treatment. Thus, there is ample scope to enlarge product coverage. Products of export interest to developing countries excluded from several schemes are

agricultural items, textile and clothing articles and certain footwear and leather articles. The expansion of GSP schemes to cover the currently excluded sectors would be justified by the increasing application of country and country-product graduation and the substantial amount of non-covered trade, especially from beneficiaries other than the major ones.

42. According to UNCTAD secretariat estimates (see annex, charts 1-4), the average proportion of GSP covered trade in the total dutiable trade for major beneficiaries of the largest GSP schemes (European Union, Japan and United States) was as high as 66.2 per cent in 1992 as against 27 per cent for remaining beneficiaries (see annex, charts 1-4). The total amount of non-covered dutiable trade for these remaining beneficiaries was, therefore, substantial. It amounted to US$ 60.3 billion for all three schemes in 1992: US$ 12.9 billion for the European Union, US$ 18.1 billion for the United States and US$ 29.3 billion for Japan." These figures show that there is still considerable scope for matching product coverage of the GSP schemes with the export structure of the large majority of the remaining beneficiaries.

43. Another measure of the potential for extending product coverage is the value of trade in non-covered items for which Uruguay Round MFN tariff rates are 5 per cent or more, as shown in table 3 of the annex. For the three major GSP schemes, trade in these items amounted to US$ 27 billion in 1992. As the table shows, the major scope for improvement in the United States GSP scheme is in the textiles, leather and footwear sectors, where the amount of non-covered trade was US$ 10.6 billion in 1992 for non-LDC beneficiaries and US$ 893 million for LDCs. Besides these statutorily excluded items in the United States GSP scheme, there remains a substantial volume of non-covered trade in other industrial items which amounted to more than US$ 1 billion for non-LDCs. In the non-tariffied agricultural sectors, the amount of non-covered trade was roughly US$ 1 billion in 1992. In total, the amount of non-covered trade was almost US$ 13 billion. The amount of non-covered trade of the European Union and Japan was roughly the same in 1992, i.e. equivalent to over US$ 6 billion.

44. The main non-covered items for the European Union were fairly evenly distributed: US$ 1.3 billion for non-tropical products, US$ 1.7 billion for natural resource based products, with the remainder concentrated on leather and other industrial items.

45. The bulk of non-covered trade for Japan was concentrated on non-tropical agricultural products which accounted for more than one-third of the total amount of non-covered trade. The remaining leading sectors of non-covered products related to tropical industrial products (US$ 934 million) and natural resource based products (US$ 736 million).

46. As already mentioned, the amount of trade in tariffied agricultural products for the three major schemes following the Uruguay Round amounted to US$ 8.1 billion in 1992. The bulk of these imports were made by the European Union (US$ 7 billion) and represented a GSP coverage ratio of 11.3 per cent. Imports by the United States and Japan amounted to more than US$ 500 million, with coverage ratios of 49 per cent and 7.3 per cent, respectively. These data point to further scope for GSP treatment in this area.

G. Depth of tariff cuts

47. With a few exceptions, eligible agricultural products do not enjoy duty-free treatment under the GSP. In some schemes, even certain industrial products do not receive a 100 per cent exemption from MFN rates of duty. In the light of the Uruguay Round tariff reductions, lower GSP rates of duty or preferably duty-free treatment for these products would be a possible way to restore meaningful preferential margins. In this context, it should be noted that, in spite of the reduction of MFN rates resulting from the Uruguay Round, there is considerable scope for potential GSP treatment in many tariff lines where duties are higher than the average post-Uruguay Round MFN rate.

48. There has been another development which could lead to further improvements in the depth of tariff cuts. In fact, in the new GSP scheme of the European Union, previous quotas and *a priori* limitations have been replaced by "tariff modulation", consisting of replacing the previous quota-limited duty-

free treatment with a reduction of MFN duty coupled with unlimited market access. The underlying approach is that instead of utilizing quotas to safeguard national industry, these quotas have been tariffied.

49. The elimination of tariff quotas is a positive development and other countries which maintain such restrictions should consider following the same path. However, it must be accompanied by a tariff modulation which maintains a workable and meaningful GSP preferential margin. The replacement of previous quotas on textile items by a 15 per cent preferential margin in addition to the application of country-sector graduation of major exporters and strict rules of origin may be tantamount to exclusion of these products from the European Union scheme.

H. Graduation

50. Since the late 1980s, some preference-giving countries have started applying graduation measures under their own definitions and criteria. The "enabling clause" agreed during the Tokyo Round seems to have been taken as a basis for such measures. This clause states that "Less-developed contracting parties expect that their capacity to make contributions or negotiated concessions or take other mutually agreed action under the provisions and procedures of the General Agreement would improve with the progressive development of their economies and improvement in their trade situation and they would accordingly expect to participate more fully in the framework of rights and obligations under the General Agreement". This clause has been interpreted by preference-giving countries to mean that as beneficiaries' trade grows and their economies develop, they should be able to take on more obligations under the GATT and eventually will no longer require GSP treatment.

51. At present there are two main types of graduation: partial, often called country-product graduation or country-sector graduation; and country or full graduation. Under the former, when exports of a specific beneficiary country for certain products or sectors meet certain trade-contingent parameters, these products are subsequently excluded from GSP treatment. However, GSP benefits continue to apply to the remaining products exported by that beneficiary. Under the full graduation criterion, a country is completely excluded from a GSP scheme when it meets certain development criteria, usually GNP per capita. In some cases, such as the United States GSP scheme, country-product graduation is reversible, i.e. the country-product pair may be reinstated if certain criteria are met. At present, under the full graduation criteria, there are no clear rules providing for an eventual reinstatement if exports diminish drastically in subsequent periods.

(i) Country-product graduation

52. The country-product graduation criterion used by the United States mainly relates to the export performance of a beneficiary country for a particular product. According to this criterion, a beneficiary is excluded from GSP benefits if it exceeds a given value of exports of an individual product, or if it exceeds a certain percentage (50 per cent) of GSP exports from all GSP beneficiaries for a particular product. In this case, GSP treatment is suspended in the subsequent year but may be reinstated at a later date.

53. In its new scheme, the European Union has elaborated a novel concept of partial graduation, that of country-sector graduation. This criterion is based on an index of export specialization combined with a development index. The specialization index is based on the ratio of a beneficiary country's share of total European Union imports in a given sector" to its share of total European Union imports. The larger the sectoral share compared with the overall share, the greater is the degree of specialization. This indicator is combined with a development index which brings together the per capita income and the manufactured exports of the beneficiary country calculated as a percentage of the same indicators of the European Union."

54. The development index is designed to balance the effect of the specialization index. On its own the latter could, for example, result in a low-income country being graduated for a sector in which it is particularly competitive. On the other hand, such country-sector graduation is accompanied

by another criterion which applies, irrespective of the development index, when the beneficiary country's exports of GSP-covered products in a given sector exceed 25 per cent of all beneficiary exports in that sector. There is also a corrective criterion for small beneficiaries whereby countries which account for a small share of GSP imports in a sector, i.e. no more than 2 per cent, are exempt from graduation.

55. Although apparently similar, these two criteria applied by the European Union and the United States reveal certain differences. The United States GSP is generally considered by its policy makers not to be a traditional aid programme but one to help improve the economic conditions of developing countries that need an extra advantage to begin or increase exporting their products. When an industry of a beneficiary becomes competitive, making GSP preferences unnecessary, such a beneficiary should be graduated from GSP eligibility with respect to that product in order to maintain GSP benefits for other beneficiaries.[20]

56. In elaborating and applying partial graduation, the European Union has emphasized the role that such graduation should play: first, and following the United States rationale, a reorientation of the GSP benefits from large beneficiaries to smaller ones; and, second, the application of graduation is not linked only to trade criteria but also to development criteria, although the latter are excluded when the additional "25 per cent" criterion is applied.

57. The specialization index used by the European Union raises a number of issues. First, a country may be specialized in a particular product owing to its comparative advantage at its stage of development. This does not, however, necessarily mean that the country is competitive for that particular product *vis-à-vis* all suppliers, whether GSP beneficiaries or developed countries. Secondly, even if competitiveness in one product within a sector is ascertained, it does not follow that the country is also competitive in the other products included in that sector. Under the European Union scheme, however, sectors are so broadly defined that non-competitive products risk being excluded from the European market along with the competitive product. Thirdly, the system may also discriminate against beneficiary countries which diversify their exports away from the European Union because a fall in the beneficiary's share in global European Union imports results in a larger specialization index.[21]

58. The European Union's development index, although conceptually valid, also gives rise to concern in that it contains an inherent bias against larger countries. This is because the higher a beneficiary's absolute export level, the higher its ranking in the development index.[22] There is *no a priori* reason, however, why size in itself should disqualify a country from GSP treatment.

59. Preliminary estimates[23] indicate that, following the introduction of these graduation criteria, the amount of trade receiving GSP preferences from the European Union may drop significantly in the coming years. If this were to occur, it would create severe problems for the affected countries. It would also remain to the seen to what extent the remaining beneficiaries will be able to replace the exports of the graduated countries, which is one of the declared objectives of the newly introduced graduation concept.

(ii) Full graduation

60. The criterion for country graduation is primarily based on per capita GNP. For example, the schemes of Bulgaria and Poland graduate beneficiaries having per capita GNP in excess of their own. The scheme of New Zealand graduates beneficiaries having per capita GNP in excess of 70 per cent of its own. The scheme of the United States graduates beneficiaries having per capita GNP in excess of US$ 11,400. The European Union intends to introduce country graduation as from 1 January 1998 on the basis of objective, clearly defined criteria for which the Commission shall submit appropriate proposals during 1997. Some other schemes, such as those of Japan and Switzerland, contain graduation provisions which have not yet been invoked.

61. As stated above, all of the existing full graduation provisions are based on a single criterion i.e. level of per capita income. Although all economic activities in a country contribute to the GNP figure, the latter does not provide a reliable measure of the level of development. There are instances, for example, where exports of a few primary commodities represent a large proportion of the GNP of beneficiary countries. Since the ultimate aim of the GSP is to achieve economic development through industrialization, it seems necessary to assers the extent to which a beneficiary country has achieved a stage of development that is comparable to that of the preference-giving countries. Full graduation should, therefore, require more than a capability to export or a given level of income.[24]

I. Safeguards

62. Two types of safeguards are applied under the GSP. One is a general safeguards clause, analogous to Article XIX of GATT, contained in all schemes and seldom used. It allows the authority in the importing preference-giving country to suspend GSP treatment and apply the MFN rate of duty when GSP imports of a particular product increase and cause injury to the domestic industry which produces like products. The other type of safeguards consists either of *a priori* quantitative limitations in the form of ceilings and maximum country amounts or of quotas and competitive need limitations. Beneficiaries affected by quantitative limitations must wait until the new GSP year in order to receive GSP treatment again; they can also be redesignated after a certain time lag if they fall short of the exclusion criteria. These mechanisms are only used by major GSP schemes. In the case of the European Union, it was used until 1994 and was replaced in 1995 by the modulation of preferential tariff margins referred to earlier. These quantitative limitations have been the major reason for the low GSP utilization rate in the European Union and Japan.[25]

J. Special measures for LDCs

63. The United Nations has established criteria to define an LDC and revises the list of countries so designated annually. At present, there are 48 LDCs. However, not all preference-giving countries recognize the full list of LDCs.[26]

64. In the GSP context, special measures for LDCs have been implemented by almost all preference-giving countries.[27] Some offer unlimited product coverage, i.e. inclusion of all dutiable products. Others grant wider product coverage than for non-LDC beneficiaries and some schemes provide deeper tariff cuts to LDCs or duty-free treatment. Two schemes offer special measures for LDCs in the context of rules of origin. One allows LDCs to use additional foreign inputs in the production of an eligible GSP product while the other provides a temporary derogation from the normal rules, which is granted on a case-by case basis upon request.

65. In spite of these special measures, LDCs are still unable to take full advantage of the system due mainly to the limited product coverage and the rules of origin, which also apply to LDCs with the above-mentioned exceptions. In 1993, only one quarter of OECD preference-giving countries' dutiable imports from LDC beneficiaries actually received GSP treatment.[28]

K. Rules of origin[29]

66. At the Intergovernmental Group of Experts on Rules of Origin held in July 1995, possible ways to harmonize, simplify and improve GSP rules of origin were examined. On the basis of the proposals made by the secretariat and in the light of the Uruguay Round Agreement on Rules of Origin, the Intergovernmental Group of Experts proposed to focus on the total harmonization of the origin criteria among preference-giving countries.

67. Under the Agreement on Rules of Origin, the work of the Technical Committee established under the auspices of the World Customs Organization (WCO) consists of elaborating a harmonized set of non-preferential rules of origin. The harmonized set will define the amount of working or processing which could be regarded as substantial transformation on the basis of the change-of-tariff-heading criterion.

68. In this connection, the Intergovernmental Group of Experts on Rules of Origin agreed that the following text should be adopted by the Special Committee on Preferences at its twenty-second session:"

"The UNCTAD secretariat is requested to:

(a) Follow and monitor, as an observer, the work carried out within the Technical Committee and, when appropriate, contribute to the technical aspects of this work;

(b) Report annually to the Special Committee on Preferences on the progress made and results achieved by the Technical Committee with a view to progressing towards harmonization of the GSP rules of origin;

(c) Propose, once the Technical Committee has achieved its objectives and taking due account of the WTO's work, a harmonized set of rules of origin, including modifications and amendments where appropriate, to UNCTAD member States, for their consideration and adoption."

69. In addition to the above text, there were a number of recommendations on improvements and simplification of GSP rules of origin which may provide scope for further discussion."

Chapter II

POSSIBLE NEW AREAS FOR THE GSP

70. The purpose of the GSP is to provide a preferential tariff margin to products originating in beneficiary developing countries and is confined to trade in goods only. There has, however, been a growing interest on the part of developing countries in extending the GSP to new areas such as services and investment." In this context it should be kept in mind that the original concept of the GSP was that, through tariff preferences, foreign direct and domestic investment would be stimulated. This clearly is a necessary condition for industrialization which is a major goal of the GSP.

71. Trade in services constitutes an important opportunity for developing countries. The General Agreement on Trade in Services (GATS) recognizes in its preamble that Members desire "...to facilitate the increasing participation of developing countries in international trade in services and the expansion of their services exports". Article IV provides, *inter alia*, that this should be achieved through specific negotiated commitments relating to: (a) the strengthening of the domestic services sector of developing countries and its efficiency and competitiveness, *inter alia*, through access to technology on a commercial basis; (b) the improvement of their access to distribution channels and information networks; and, (c) the liberalization of market access in sectors and modes of supply of export interest to them. Thus it provides the framework within which preferential treatment could take place.

72. Major asymmetries exist with respect to the degree of development of the services sector in developed and developing countries. Most developing countries have neither the capital nor the expertise to compete globally. Moreover, developing countries face some inherent disadvantages resulting from governmental measures and from anti-competitive activities of market operators which relate to the established arrangements of accessing markets. For example, immigration regulations are often applied differently to nationals of developing countries, thus limiting the movement of natural persons; and the cost of telecommunications or transport rates for shipping goods to developed countries are higher than the rates applied among developed countries.

73. Various mechanisms could be devised to correct these asymmetries. As a first step, benefits comparable to those enjoyed by OECD countries under regional arrangements or otherwise relating to supply of services and services regulations could be offered to developing countries. Moreover, additional market access and national treatment commitments can be undertaken under the GATS which would not be extended to developed countries. Such measures could make an important contribution to developing a competitive services sector, in line with UNCTAD's objectives and mandate in this area.

74. Barriers to trade in services, however, take the form of regulations rather than measurable tariffs or other quantifiable parameters. It is, therefore, difficult to identify a set of preferences that can be given automatically to developing country exporters. The proposals for a GSP in services must, therefore, adopt a more specific sectoral and mode of supply approach. A sector-by-sector analysis would help to identify possible areas in which preferential or special treatment would be appropriate. This would necessitate the study of the regulatory framework for services, including visa, licensing, standards and qualifications, as well as existing preferential arrangements, e.g. bilateral agreements, regional agreements, networking, etc.

75. The feasibility of some possible forms of special competitive advantage in various service sectors could be further explored. Such measures could include: (a) movement of natural persons and business services, where more flexibility could be granted on visa, entry and work permit requirements, removing economic needs tests, recognition of qualifications, and accreditation, licensing requirements and tax relief on foreign workers' earnings; (b) in tourism a larger duty-free allowance could be applied for goods which returning residents bring back from developing countries; (c) in developed countries, tax credits could be made available for tourism activities and for participation in conventions in developing countries; (d) in the construction and engineering sector, preferential treatment could be granted on the value of performance

bonds required of suppliers for a particular project; (e) in the air transport sector, traffic rights could be enlarged on a preferential basis for developing country airlines and preferential access at lower cost could be envisaged to networks such as cargo handling facilities, check-in counters and computer reservation systems."

76. A further instrument to promote developing country exports of services would be through government procurement liberalization beyond that agreed in the Uruguay Round. In addition, developing-country bidders on developed country domestic and overseas projects could be given a margin of preference.

77. As regards labour services undertaken in the importing country, the developed countries could enter into consultations with the developing countries to enable them to plan human resource requirements in such areas as medical education and nurses' training, where the developing countries already supply trained personnel on a temporary basis to the developed countries.

78. In addition to trade in services, foreign direct investment (FDI) has been explored for possible expansion of the GSP concept. There are two main possible areas of state intervention in FDI: the fiscal regime and investment insurance. In the first case, developed countries could grant tax relief to corporations having investments in developing countries on any tax saved by them in the host developing country through incentives such as tax holidays. Many important home countries for FDI currently provide little in the way of such relief. The second area involves Government agencies which provide firms investing abroad with insurance coverage larger than private firms and at better terms. Here, one possible measure would be to strengthen the financial means available to agencies charged with promoting investment in developing countries. The experience of the FDI regime in the United States, where the publicly-funded Overseas Private Investment Corporation (OPIC) is more actively involved in promoting FDI than its European counterparts, suggests that differences in fiscal treatment and management of public insurance may directly or indirectly influence FDI in developing countries.

79. One concrete way of implementing preferential treatment could be that public investment guarantee agencies adopt a more liberal approach to investment in developing countries. This would contribute to increasing the flow of FDI to developing countries in general, and to ensuring a wider spread of FDI among them, in particular to smaller, lower-income developing countries.

Chapter III

REVITALIZATION OF THE GSP

80. The Uruguay Round Agreements provide one justification for a comprehensive review of the GSP, since they have resulted in an erosion of the preferential margins which developing countries enjoyed under GSP schemes. On the other hand, the Round also presents new opportunities, particularly for extending GSP coverage to agricultural and textile and clothing products. But a review is also warranted on other grounds. While the GSP has been of undoubted benefit in increasing the exports of beneficiary countries as a whole, it has fallen somewhat short of initial expectations. Although the share of beneficiary exports receiving preferential treatment in OECD markets grew from 20 per cent of dutiable trade in 1976 to 26.2 per cent in 1993, this is still a relatively low share. In the case of the LDCs this share actually declined from 26.8 per cent to 25.4 per cent over the same period. Another unexpected development has been the concentration of benefits among a few large exporters.

81. It has been argued that preferences could prove detrimental to the interests of the benefit-receiving country in that they could lead to over-investment in an industry and give rise to adjustment problems when the preferences were eroded or removed. They could also generate a dependence on uncompetitive sectors which would otherwise have died and whose resources could have been shifted to sectors with an underlying comparative advantage. There is no question that preferences could turn out to be a 'poisoned chalice', particularly where guaranteed markets in the preference-giving country, almost regardless of competitiveness *vis-à-vis* other producers, are offered. But the GSP is unlikely to have had these perverse effects, given that beneficiaries' exports have generally enjoyed low preferential margins. The three largest schemes have all used *a priori* mechanisms to limit GSP utilization on individual products by competitive countries. The countries affected by these restrictions all have well-diversified export industries. There is no evidence that the small countries (measured in terms of their market penetration in the preference-giving countries) have unduly concentrated on particular export industries on the strength of GSP preferences. *A fortiori* the evidence that the GSP has generated investment in such industries is patchy and anecdotal. On the contrary, the principal disappointment with the GSP is that it has not achieved more in helping beneficiary countries, especially the weaker ones, develop a strong and diversified manufacturing base.

82. There is, therefore, room for strengthening the GSP so that it can better fulfil its role. The adjustments proposed here are intended to reinforce the GSP, which has lacked the necessary tools to achieve its original objectives. For a start, three further precepts might constructively be added to give new strength to the GSP's underlying principles: these are transparency, stability and predictability.

83. Transparency implies, for example, that *a priori* restrictions on the availability of GSP treatment to a country's exports of a particular good, or in a particular sector, should clearly differentiate the issue of whether that country has become competitive, and thus no longer needs GSP treatment, from concerns over damage to the preference-giving country's domestic industry. It would rule out any discretionary decisions excluding specific products from certain countries.

84. Predictability would require a continuity of benefits without abrupt interruption and sufficient warning periods prior to changes, as individual exporters generally have no way of knowing whether GSP status will be allowed on a particular consignment. In a broader sense, predictability would require that each preference-giving country was committed to continue its scheme for a sufficient period to make investment in benefiting export industries viable.

85. Finally, at a time when preference margins have been substantially eroded by the Uruguay Round tariff reductions, when more and more preference-giving countries are graduating, or planning to graduate, individual developing countries entirely from their schemes, and when traditional mechanisms for country-product graduation are being increasingly used or replaced by other mechanisms which limit the benefits of the scheme, it may reasonably be proposed

that another precept should be introduced. This is that preference-giving countries should aim to stabilize on the basis of pre-Uruguay Round data, if not to increase, the total value of their GSP schemes measured in terms of customs revenue foregone and the amount of trade which received GSP treatment. This would imply a continuous examination of each scheme by the authorities in the preference-giving country with a view to expanding coverage and increasing preference margins for the remaining beneficiaries.

86. There is also a need for greater consistency in applying the existing principles of generality and non-discrimination, which imply that all developing countries that meet various income and other relevant criteria should benefit from as wide a GSP product coverage as possible. Exclusions should be limited to action taken under the general safeguard clause contained in all schemes. Import-sensitive sectors in preference-giving countries, moreover, should only be cushioned by modulation of GSP preferences and such modulation should still result in a meaningful GSP margin. Safeguard actions and the modulation of tariff preferences should, moreover, be confined to those goods, defined at no higher than the six-digit HS level, where there is a clear and serious threat to the preference-giving countries' own domestic industry. LDCs should be exempted from such measures.

87. The principle of non-reciprocity is currently undermined by proposals to introduce conditionality relating to such matters as environmental and social factors, as in the case of the European Union scheme, or by the established procedure under the scheme of the United States whereby GSP eligibility is assessed against beneficiary practices on intellectual property rights or internationally recognized workers' rights. These measures make full, or enhanced, GSP eligibility conditional upon compliance with non-trade related criteria.

88. As for the contents of GSP schemes, the recent experience of beneficiaries and the intergovernmental deliberations in UNCTAD have been drawn upon to formulate some policy options designed to revitalize the GSP. These concern product coverage, depth of tariff cuts, graduation mechanisms, safeguards, special treatment for LDCs and the rules of origin.

89. Product coverage should be extended to all products. The tariffication of non-tariff barriers in temperate-zone agricultural products, and some innately tropical products such as rice and tobacco, allows them to be straightforwardly incorporated in the GSP. In some cases the tariffs are set at very high levels, often over 100 per cent. Textile products should likewise be introduced into all GSP schemes for all beneficiaries. In including new sectors, there may initially be justification for some modulation so that the tariff margin is less than the full MFN tariff and the impact on domestic industries of preference-giving countries cushioned. Other sectors excluded from certain schemes could in many cases be incorporated. Sometimes exclusions persist owing to the lobbying activities of industrial groups, or through historical inertia, rather than because of any serious threat to the domestic industry. Detailed examination of particular sectors is, therefore, called for in all schemes. Among the larger schemes, coverage should be expanded in natural resource-based products, leather, footwear and many metals and minerals in the European Union; tropical industrial products and natural resource-based products in Japan; textile and clothing products, footwear, certain industrial goods such as glass and ceramic products and some chemicals in the United States.

90. The general rule on the depth of tariff cuts should be full exoneration from tariffs. However, in the interests of transparency and predictability some modulation of tariff cuts is preferable to maintaining *a priori* restrictions. The avowed purpose of these restrictions, that is the redistribution of the benefits of the GSP from competitive producers to smaller producers, can best be achieved through clear country-product graduation mechanisms coupled with expansion of product coverage for the remaining beneficiaries. Where tariff modulation is used, the resultant preference margin must be of a commercially meaningful dimension, or exporters will find that the transaction costs of applying for GSP status on their exports will not justify the benefits.

91. The criteria for country-product graduation should be based on the

objectives underlying the GSP. These imply that if the ultimate objective of country-product graduation is the exclusion of "competitive" products, the principal criterion should be the share of that country's exports in the total worldwide imports of the preference-giving country, not only those imports benefiting from the GSP.

92. The competitiveness criterion should, moreover, be supplemented by development criteria, which could include (a) a measure of income per capita; (b) the share of manufactured exports in total exports; and (c) a measure of export diversification, such as that developed and regularly published by UNCTAD. If the withdrawal of GSP treatment were to result in a significant reduction in that beneficiary's exports of graduated products to the preference-giving country, GSP treatment should be reestablished.

93. The level of aggregation of products to be excluded for the purposes of country-product graduation must be clearly defined. It should ideally be defined at the six-digit HS level or the national tariff line level to avoid the risk that a country is graduated across a sector, or broad range of products, when in fact it is only competitive in value terms in specific products included in that sector, and to avoid excluding items produced either downstream or upstream. A narrow classification could, however, risk graduating specific products where imports in the preference-giving country are small and/or where the sources of those imports are a small group of countries. This situation could be dealt with through the insertion of a "de minimis" clause as in the case of the schemes of the European Union and United States.

94. Criteria for country graduation should also be based on the original goals of the GSP. This implies that, in addition to the development criteria mentioned above, they should also include other measures of the standard of living, including social indicators. In this context, the UNDP Human Development Index, which incorporates health, education and standard of living components, might be considered a possible source of complementary criteria.

95. As with country-product graduation, country graduation should be reversible if the criteria are not satisfied at any period after graduation. GSP status should only be withdrawn after the criteria have been satisfied for at least three successive years. In addition, GSP benefits should be withdrawn gradually over at least three years, through the digressive application of preference margins.

96. The application of safeguards should be distinct from graduation. Safeguard measures modelled on Article XIX of the GATT and the WTO Agreement on Safeguards are appropriate when surges of preferential imports cause, or threaten to cause, injury to domestic industry. Neither *a priori* limits on preferential treatment nor product or country-product graduation mechanisms should be used as safeguard measures. The former should be replaced by tariff modulation as in the new scheme of the European Union in order to impart predictability and transparency to the GSP users. Tariff modulation should, however, result in meaningful GSP margins. The country-graduation mechanism should be based on a strict test of competitiveness as discussed above.

97. The special treatment accorded to the least developed countries (LDCs) needs to be strengthened to correct the situation under which they have benefited less from the GSP than other preference-receiving countries, both in terms of the share of their dutiable exports to the OECD countries which receive preferential access and in terms of the rates of growth of their preferential exports since the GSP started. In addition, the LDCs are unlikely to derive immediate gains from the implementation of the Uruguay Round Agreements. The preference-giving countries could therefore accord LDCs: (i) comprehensive product coverage of all dutiable products, including those not currently covered under the special treatment provision accorded to LDCs by preference-giving countries. This expansion of product coverage should be accompanied by the granting of duty-free treatment to the newly-eligible products; (ii) relaxation of the existing rules of origin, including full and global cumulation, and flexible administration of documentary and shipment requirements, in particular abolition of the quality paper requirement for GSP Form A and of the direct consignment rule. A derogation procedure should be established by all preference-giving countries; and (iii) provision of resources to create within

the UNCTAD Technical Cooperation Programme on GSP and Other Trade Laws an ad hoc project for LDCs.

98. As far as rules of origin are concerned, the Uruguay Round Agreement on Rules of Origin has provided new impetus to progress towards their harmonization. In particular, the work of the Technical Committee of the World Customs Organization (WCO) will consist of elaborating a harmonized set of non-preferential rules of origin. The purpose of, and one of the major difficulties in, developing such a harmonized set of rules of origin is to define the amount of working or processing which could be regarded as substantial transformation on the basis of the change-of-tariff-heading criterion. Thus, the work of the Technical Committee can be taken as a guide and reference for harmonizing rules of origin. In this context, it is expected that the agreed conclusions of the Intergovernmental Group of Experts on Rules of Origin concerning harmonization of rules of origin will be endorsed at the twenty-second session of the Special Committee. In addition, the recommendation on the simplification and improvement of the rules of origin should be further discussed in order to identify concrete measures for this purpose.

99. This report has considered new areas for GSP-type programmes in the field of services and foreign direct investment. Clearly much more study is required if a set of concrete and practicable proposals is to be drawn up. In the services sector, for example, obstacles to trade generally take the form of national regulations rather than measurable barriers like tariffs, so that conventional GSP-type preferences cannot be applied and would have to be replaced by a tailor-made mechanism. This report has identified a number of possible measures entailing preferential treatment which could be the subject of further analysis. The investment area offers prospects for preferential treatment, particularly in the fiscal and investment guarantee domains.

100. With the assistance of both preference-giving and preference-receiving countries the UNCTAD Technical Cooperation Programme on the GSP and Other Trade Laws" needs to be further strengthened. There have been two major evaluations of GSP technical cooperation which recommended improvements to the Programme. In addition, useful recommendations were made by the first Ad Hoc Expert Group Meeting in 1994. To the extent possible, these recommendations have been implemented in a satisfactory manner, as evaluated by the second Ad Hoc Expert Group Meeting."

101. In the course of the implementation of the Uruguay Round Agreements, requests for assistance are expected to be added to those already pending, which to date amount to 29." In recent years, the Programme's activities have been expanded, following specific requests from developing countries, to cover trade laws complementary to GSP, such as anti-dumping, subsidies, non-preferential rules of origin, and regional preferential arrangements. In addition, some of the activities carried out covered different aspects of market access to preference-giving countries, placing the GSP schemes in the overall context of the trade policy of preference-giving countries. This trend has been acknowledged and supported by the Special Committee on Preferences at its twenty-first session."

Notes

1. See TD/B/SCP/4, annex I.

2. For details, see TD/B/SCP/9 and TD/B/SCP/15.

3. See UNCTAD Trade and Development Report, 1994, and Supporting Papers, annex I to chapter I.

4. See "Assessment of the Generalized System of Preferences Program" prepared by the United States General Accounting Office (GAO), GAO/GGD-95-9, November 1994, p.97.

5. GAO/GGD-95-9, November 1994, op.cit.

6. Among the OECD countries Australia is excluded from these and subsequent totals owing to data problems. Among non-OECD preference-giving countries only Hungary is included in the totals.

7. See UNCTAD/ITD/8.

8. The average rates for the European Union are based on the period 1978 to 1992.

9. See "A Synthesis of the GSP Study Programme", study by Craig R. MacPhee, UNCTAD/ITP/19.

10. ESCAP, "GSP Graduation, International Trade, and Investment in the Asia and Pacific Region", UN 1992.

11. See TD/B/WG.8/2.

12. These are: pharmaceuticals, construction equipment, medical equipment, steel, beer, furniture, farm equipment, spirits, wood, paper, toys.

13. See GATT "Increase in market access resulting from the Uruguay Round", 12 April 1994, table 5.

14. The trade weights are those of beneficiary countries whose exports to the markets actually entered under the GSP. For the European Union, trade weights exclude ACP trade since those countries export to the European Union under the Lomé Convention and not the GSP, and similarly for the United States, CBI trade is excluded.

15. See TD/B/WG.8/2.

16. See TD/B/WG.8/2.

17. Figures for fiscal year 1993.

18. In the GSP legislation of the European Union, there is no clear definition of sectors. However, it may be assumed that the sectors correspond to those indicated in Annex II of Regulation 3281/94 published in Official Journal L 348 of 31 December 1994.

19. For major GSP beneficiaries under the previous scheme, the development index varies from -0.65 to -1.80. Examples of beneficiaries with a development index between -0.6 and -1, and thus the most developed under the GSP scheme, include Hong Kong, Republic of Korea and Singapore. The second most developed group of countries, those with an index between -1 and -1.23, include Brazil, Malaysia, Mexico and Thailand. They are followed by countries with an index between -1.23 and -1.7 such as Argentina, China, India, Indonesia and Venezuela. Countries with an index between -1.7 and -2 include Chile, Colombia, Pakistan, the Philippines and Uruguay. Countries with indexes of less than -2 include Ecuador,

Bolivia, Sri Lanka, CIS Republics as well as most Central American countries, including Costa Rica (Index values provided by the European Commission.)

Mathematically the development index is equal to half the sum of the logarithm of income (relative to the EU) plus the logarithm of manufactured exports (relative to the EU). Country-product graduation is applied when the two parameters so elaborated are combined as follows:

- for countries with a development index greater than -1, when the specialization index equals or exceeds 1;

- for countries with a development index between -1 and 1.23 when the specialization index equals or exceeds 1.5;

- for countries with a development index between 1.25 and 1.70 when the specialization index is equal or exceeds 5;

- for countries with a development index between 1.70 and -2 when the specialization index equals or exceeds 7.

20. GAO/GGD-95-9, November 1994, op.cit.

21. See "Trade Policy Review, European Union", Report by the World Trade Organization secretariat (WT/TPR/S/3, p.3), June 1995.

22. See "Trade Policy Review, European Union", Report by the World Trade Organization secretariat (WT/TPR/S/3, p.3), June 1995.

23. UNCTAD secretariat estimates based on Annex II, Part I of EC Regulation 3281/94 published in Official Journal L348.

24. The level of development is best captured by a combination of economic and social indicators. For a thorough discussion about the inclusion of social indicators, see "Criteria for graduation under the Generalized System of Preferences" (UNCTAD/ITD/GSP/24), by Tracy Murray.

25. In 1992, 49.5 per cent of GSP-covered products in OECD GSP schemes as a whole were granted GSP treatment. See, TD/B/SCP/6, 1 March 1994, op.cit.

26. UNCTAD/ITD/GSP/22, 1 May 1995, op.cit.

27. See also The Least Developed Countries Report, 1995, pp. 128-134.

28. US$ 3.5 billion worth of dutiable products were exported to OECD preference-giving countries by LDC beneficiaries, of which US$ 1.7 billion, or 53 per cent, were covered by the schemes and almost US$ 0.9 billion, or 53 per cent, of the GSP-covered products were actually accorded GSP treatment. See TD/B/SCP/12.

29. For the full proposals concerning rules of origin, see TD/B/SCP/AC.1/2 prepared for the Intergovernmental Expert Group on Rules of Origin and the report of the Intergovernmental Expert Group contained in TD/B/SCP/14.

30. See TD/B/SCP/AC.1/L.2.

31. These recommendations are contained in the Agreed Conclusions of the Intergovernmental Group of Experts on Rules of Origin, (TD/B/SCP/14).

32. In this connection, at the closing of the twenty-first session of the Special Committee on Preferences, the Group of 77 presented the "Declaration of the Group of 77 regarding the 1995 policy review on the GSP" which called for various measures to be taken by preference-giving countries. Paragraph (g) states that "The GSP should be revitalized, introducing new elements such as preferential treatment for trade in services and regarding foreign direct investment. The Chairman's summary of the twenty-first session of the Special Committee on Preferences in 1994 states that "There were discussions on enlarging the scope of the GSP to embrace trade in services and investment. Some developing countries requested the secretariat to undertake a study on this issue for the 1995 policy review".

33. Where applicable, some other discriminatory practices could also be removed, such as the discriminatory use of charges for airports and airways, user charges at airports to cross-subsidize domestic air services, regulations allowing only domestic firms to discount, override or rebate on tickets and freight, and discriminatory practices in allocation of terminals and time slots. The possibility of tax relief to developing countries' subsidiaries and branches in developed countries could also be considered.

34. For further information on the UNCTAD Technical Cooperation Programme on the GSP and Other Trade Laws, see TD/B/SCP/12.

35. See TD/B/SCP/15.

36. The implementation of the Uruguay Round Agreements in preference-giving countries' trade legislation will entail a major effort on the part of the Programme to update all the handbooks covering the GSP schemes and other trade laws of all preference-giving countries. All tariffs and other GSP-related information contained in UNCTAD's "Trade Analysis and Information System" (TRAINS) will also have to be updated.

37. See report of the Special Committee on Preferences at its twenty-first session, TD/B/SCP/10.